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SUBJECT: NORTHERN THAILAND CREATES A SPACE FOR U.S. INVESTMENT

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Summary

¶1. Northern Thailand boasts many attributes that are attractive to foreign investors, including low labor and land costs, making the region an inviting alternative to the growing costs of operating in Bangkok. Moreover, favorable tax incentives in the north, combined with sophisticated transportation networks that link the land-locked north to the Lamchabang seaport near Bangkok, are defining the region as ripe for U.S. investment. This favorable investment climate is also beneficial to other foreign investors, including the Chinese, who will be the primary beneficiaries of infrastructure projects slated for completion in the next few years. Nonetheless, northern Thailand is creating an investment climate that could draw U.S. investors, whom government officials believe might help balance China's growing economic influence in the region. These pull factors form a solid foundation, but the region's leaders will also need to mount an effective marketing strategy in order to sell U.S. investors on northern Thailand. End Summary.

Incentives for FDI in Northern Provinces

¶2. Northern Thailand's low labor and land costs make it domestically competitive for economic activity. Now, creative tax incentives are making the region ripe for foreign direct investment (FDI) as well. Thailand's Board of Investment (BOI) categorizes the 17 northern provinces as zone 3, which boasts the country's most generous tax incentives for foreign investors. In zone 3, for example, firms enjoy an exemption from import duties on machinery and from corporate income tax for the first eight years of operation followed by a 50% exemption over the next five years. They also enjoy double tax deductions on expenses such as transportation costs, electricity, and water usage for ten years. In the three least-developed provinces of zone 3 (Phayao, Phrae, and Nan), additional incentives are provided, such as a tax deduction valued at 25% of the construction costs for the first ten years.

¶3. These incentives have been a magnet for about \$520 million of U.S. capital in northern Thailand over the past 20 years. This investment represents a range of sources, from large corporations like Pepsi-Cola to small enterprises such as fly fishing firms, and includes both the manufacturing sector and the agricultural sector.

Land.

¶4. The success of two large corporations in northern Thailand is

a testament to the potential for American investment in the region's arable and affordable land. Pepsi-Cola's Frito-Lay factory in Lamphun province, which has been in operation since 1995, is an example of how American business and Thai government cooperation can lead to profit generation for the firm and economic development for northern Thailand. Frito-Lay has worked closely with Thailand's Royal Project Foundation and the Ministry of Agriculture and Cooperatives to develop a profitable potato farming sector, which provides revenue for local farmers and low-cost inputs for the snack foods it produces for sale on the domestic Thai market. Currently, Pepsi-Cola invests about \$75 million in northern Thailand and purchases over 30,000 tons of potatoes annually from over 5,500 local farmers. The company is concerned, however, that local production of potatoes cannot meet production demand for potato chips and is advocating for lower tariff rates on potatoes imported from the U.S.

¶5. While Pepsi-Cola's cooperation with the Thai government has contributed to its success in the region, Monsanto, an agro-technology firm that operates in Phitsanulok province, cites good climate and farmer loyalty as the primary benefits of investing in the land of Thailand's lower north. According to Monsanto, Phitsanulok is an ideal destination for its investment because: it is the center of Thailand's corn belt; local farmers abide by the company's regulations and remain loyal to the company; and the climate is at low risk for natural disasters. Monsanto's success in investing \$37 million in northern Thailand and contracting 15,000 Thai farming families has led it to expand its investment into two other agricultural firms operating in the north, Cargill and the Seminis Company.

.and Labor

¶6. While some U.S. firms have benefited from the land of

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northern Thailand, manufacturing and service sector firms have found benefit in the region's abundant and inexpensive labor. Labor-intensive firms have clustered their investments in the populous provinces of Chiang Mai and Lamphun, where the Northern Region Industrial Estate is located. (Note: The NRIE is a parastatal enterprise charged with building the infrastructure for industrial parks). Because of relatively higher transportation costs due to the region's inland location, northern manufacturing firms tend to produce lightweight products such as small electronic parts, jewelry, cosmetics and accessories, and fishing flies. Urbanization in these two provinces is also leading to greater investment in service franchises, including U.S. food and merchandise retailers such as Starbucks, McDonald's, KFC, Subway, Pizza Hut, Swensen's, and Burger King. With ample labor and growing middle-class markets, as well as booming tourist and expatriate populations, it is likely that such services investments will continue to expand in northern Thailand urban centers.

What About China?

¶7. Regardless of any future action by U.S. investors, Chinese investment is expected to flow into northern Thailand rapidly over the next two to three years, according to the outgoing Director of the Board of Investment's Northern Regional Office. She said that with the Greater Mekong Subregion (GMS) transportation network planned for completion in 2011 (primarily the construction of a bridge over the Mekong River connecting Thailand and Laos at the town of Chiang Khong), Chinese investors will ramp up their rate of investment in the northern provinces. She expressed anxiety about China's growing economic influence over Thailand, and said that it is important for Thailand to keep its foreign investment diversified.

Comment

18. With many factors working in its favor for foreign investment -- tax incentives, cheap land and labor, and improving transportation networks -- northern Thailand now faces the challenge of selling itself globally and, in particular, to U.S. investors. The existence of large American firms operating in the region, such as Pepsi-Cola and Monsanto, is a testament to the potential for U.S. investment. However, if northern Thailand seeks to attract more U.S. investors in an effort to balance the anticipated growth of Chinese investment in the region, government and business leaders will have to mount an effective strategy in order to market the north to the U.S. This is of particular import in overcoming two negatives: political uncertainty (and thus investor skittishness) since the September 2006 coup d'etat; and lengthy travel times (generally, it takes a full day longer to reach northern Thailand from the U.S. than it does to reach most other major Asian markets).
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